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Supreme Court of the United States

OCTOBER TERM, 1952

No. [redacted] 91

WELDON D. SMITH,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Weldon D. Smith, respectfully prays that a writ of certiorari be issued out of and under the seal of this Court to review the judgment of the United States Court of Appeals for the Second Circuit, entered on April 10th, 1953, which reversed a decision of the Tax Court of the United States, holding that the Commissioner of Internal Revenue erred in disallowing a deduction made by the petitioner on his 1945 Federal individual income tax return, of a bad debt, as one the loss from the worthlessness of which was incurred in the petitioner's trade or business, pursuant to Section 23 (k) (1) of the Internal Revenue Code, Title 26, U. S. C., Section 23 (k) (1).

Opinions Below.

The opinion of the Court of Appeals for the Second Circuit (R. 80-84) is not yet reported. The TAX Court OPINION (R. 52-78) IS reported AT 17 T.C. 135

Jurisdiction.

The judgment of the United States Court of Appeals for the Second Circuit was entered on April 10, 1953 (R. 84, 85). The jurisdiction of this Court is invoked under U. S. C. Title 28, Section 1254 (1) and Section 1141 (a) of the Internal Revenue Code, U. S. C. Title 26, Section 1141 (a).

Questions Presented.

1. Whether the Court of Appeals erred in its reversal of a decision of the Tax Court on a question of ultimate fact, based on specific findings, and not clearly erroneous, as to what constitutes "trade or business" within the meaning of Section 23 (k) of the Internal Revenue Code.

2. Whether the Court of Appeals was in error in holding that as a matter of law, the varied and extensive engagement in the management of, investment in, and loaning of money to corporate and non-corporate business enterprises, by an individual taxpayer, over a long period of years, is not a trade or business within the meaning of Section 23 (k) of the Internal Revenue Code.

Statement of the Matter Involved.

The petitioner filed his 1945 cash basis Federal individual income tax return with the Collector of Internal Revenue for the 28th New York District (R. 52). On this return he deducted a bad debt in the sum of $38,220.00, as one the loss from the worthlessness of which was incurred in his "trade or business", pursuant to Section 23 (k) (1)

of the Internal Revenue Code, Title 26 U. S. C., Section 23 (k) (1). The Commissioner denied this deduction on the ground that it did not result from a loan but a capital investment and that the loss had occurred prior to the year 1945 (R. 60).

The Tax Court held by a divided Court (10-6), that the Commissioner was in error and that the petitioner was entitled to a business bad debt deduction in the year 1945, in the sum of $38,220.00. *Weldon D. Smith v. Commissioner of Internal Revenue,* 17 T. C. 135 (R. 52-76).

The Tax Court found as an ultimate fact that "Petitioner was in the business of giving financial aid and personal services to business ventures and, therefore, that the $38,220.00 represented a bad debt which arose from a business regularly engaged in by petitioner which became worthless in 1945" (R. 62).

The dissenting opinion written by Judge Disney did not quarrel with the facts as found by the majority of the Court, but held that the debt was a "non-business debt" within the meaning of Section 23 (k) (4) of the Internal Revenue Code, Title 26, U. S. C. Section 23 (k) (4) (R. 76).

This was not even the basis for the disallowance of the deduction by the Commissioner as can be seen above.

There was another issue before the Tax Court, but it is of no concern here, as the Commissioner stipulated that his appeal to the Court of Appeals was not intended to be from that part of the Tax Court's decision dealing with that issue. He acquiesced in the portion of the decision not appealed from and the record on appeal in the Court of Appeals was prepared in reliance on and pursuant to the stipulation. That portion of the transcript of the testimony, and those exhibits having to do only with the other issue were omitted from the record (R. 78, 79).

The Findings of Fact of the Tax Court on the bad debt issue are as follows:

"Petitioner began to work for Adam, Meldrum and Anderson Co., Inc., (hereinafter referred to as A. M. & A.), a department store in Buffalo, New York, in 1922, as comptroller. He later became a director, treasurer, vice-president, and general manager. He was a substantial stockholder, holding more common than preferred stock.

On November 8, 1934, petitioner and A. M. & A. entered into a written contract of employment, whereby he was to serve as general manager for a period of 10 years beginning January 1, 1935" (R. 52).

"In 1936, petitioner met the Houck family (three brothers and their mother) who operated Llenroc Farm located on the Canadian side of the Niagara River near Buffalo. The farm had been operated by the Houcks since 1915, at first by the father and then by the sons following their graduations from Cornell Agricultural College. They engaged in dairy farming and raised prize cattle. After their father's death, in the early 1930's, the sons had to seek other employment because of economic conditions. At the time petitioner met the Houcks, they were desirous of finding someone to assume business management of the farm.

Petitioner had been raised on a farm and was 'a little bit' of a cattle fancier. In January, 1937, after a number of conferences with the Houcks at which the history, past earnings and future financial possibilities of the farm were discussed, and after petitioner and one of the Houcks each had an independent appraisal of the farm made, petitioner and the Houcks formed a Canadian corporation known as Llenroc Farms, Ltd., (hereinafter referred to as Llenroc).

The corporation was capitalized at $20,000, petitioner paying $4,000 cash, and the Houcks contributing the farm property, implements and animals in payment for their stock. Each stockholder owned 20 per cent of the stock.

Petitioner was interested in the farm as a business enterprise, not as a hobby. He was the treasurer and general manager, and supervised the personnel, purchasing, seeding plans, crop gathering, etc. He attended to those matters in the evenings, Saturdays and Sundays. A farm manager was hired to take charge of actual operations, and he lived on the farm. Neither the Houcks nor petitioner used the farm as a residence, nor for vacations.

Shortly after incorporation, in the summer of 1937, the cattle herd became infected with tuberculosis and was destroyed by the Government, which paid Llenroc only a nominal amount (R. 57, 58).

From 1937 through 1943 petitioner deposited his own money to the credit of Llenroc and made purchases for Llenroc. In the four months following Llenroc's incorporation on January 29, 1937, petitioner made the following deposits to Llenroc's account:

2/27/37	$ 125.00
3/ 1	1,175.00
3/ 5	500.00
3/17	700.00
3/22	500.00
4/ 2	500.00
4/ 9	300.00
4/19	200.00
5/ 5	600.00
5/10	300.00
5/13	600.00
5/20	200.00
5/25	200.00

The other stockholders also did so, but to a much smaller extent since they did not have any more money available. Cumulative balances of these amounts, as they appeared in Llenroc's books during the years of its existence, were as follows:

Date	*Total*	*Petitioner*	*W. L. Houck*	*C. T. Houck*	*J. E. Houck*
1/31/38	$21,863.78	$19,863.78	$1,800.00	$200.00	
1/31/39	30,563.78	28,563.78	1,800.00	200.00	
1/31/40	36,250.00	34,250.00	1,800.00	200.00	
1/31/41	37,050.00	35,050.00	1,800.00	200.00	
1/31/42	37,650.00	35,650.00	1,800.00	200.00	
1/31/43	39,150.00	36,650.00	2,050.00	325.00	$125.00
1/31/44	41,520.00	38,070.00	3,000.00	325.00	125.00
1/31/45	41,520.00	38,070.00	3,000.00	325.00	125.00
10/30/45	41,670.00	38,220.00	3,000.00	325.00	125.00

The largest amounts appear as of January 31, 1938 (Llenroc was on a fiscal year ending January 31), and were partly occasioned by the replacement of the herd following its destruction. It was the understanding of the stockholders that these amounts would be returned as soon as Llenroc could do so. They were carried on the financial statement as "Stockholders Accounts" under current liabilities (R. 58, 59). At the beginning, petitioner as treasurer of Llenroc, made out corporation interest bearing notes to himself, but did not continue this through the years. No interest was ever paid since Llenroc did not have the money to pay it.

Each year, from the time of its incorporation, Llenroc's expenses were greater than its gross profits. Since its opening financial statement had a 'special reserve' of $13,617.65, no deficit appeared until the statement of January 31, 1942. A summary of the Surplus Account is as follows:

Surplus Reserve (Deficit)	
1/31/38	$13,617.65
1/31/39	8,541.48
1/31/40	5,437.75
1/31/41	1,791.50
1/31/42	(2,022.59)
1/31/43	(2,680.36)
1/31/44	(6,950.29)
1/31/45	(13,704.63)

The Capital Stock Account at all times was $20,000. In his 1944 income tax return, petitioner claimed a deduction of $4,000 for his Llenroc stock as being worthless, which deduction was allowed.

The farm was encumbered by large mortgages and was taken over by the mortgagee in the summer of 1945. Following this, in October, 1945, Llenroc filed a general assignment of all its assets for benefit of creditors under the Canadian Bankruptcy Act. In his 1945 income tax return petitioner claimed a deduction of $38,220 as a debt owed him by Llenroc which became worthless during that year. Respondent denied this deduction on the alternative grounds that it was not a loan but a capital investment, or, if a loan, it had become worthless before 1945 (R. 59, 60).

Petitioner filed a claim as a creditor in the amount of $38,220 with the trustee in bankruptcy which was allowed. In the final statement by the trustee in bankruptcy four classes of creditors were listed: secured creditors, preferred creditors, ordinary creditors and directors' claims (contingent). Petitioner's claim was in the last class. The secured and preferred creditors received 100 per cent dividends, the ordinary creditors received 35 per cent dividends, while those falling in the last class (including petitioner) received 2.047 per cent. Petitioner received this

dividend amounting to $1,056.83 in 1949, the year in which the bankrupt estate was closed and the trustee discharged. Petitioner reported this amount in his income tax return for 1949.

Petitioner had invested money in a number of enterprises and had investigated possibilities of many more. In addition to purchasing stock in small corporations, he lent money or else allowed his earnings to remain in the venture and draw interest. These earnings left on deposit were not always available for withdrawal. He not only put his money into enterprises but also participated in their management, being an officer or director, or both. He owned stock in A. M. & A. and left some of his earnings in the corporation upon which he received six per cent interest. He was a director and officer until the difficulties which arose in the early 1940's. He held 49 per cent of the stock of Adam, Meldrum & Anderson Cleaning Corporation (unrelated to A. M. & A.), and was an officer and director. He left some of the salary credited to him in the business. Until the business was sold in 1944 or 1945 he would spend several hours per day at the cleaning plant. Petitioner was also a stockholder and director of Adam, Meldrum and Anderson State Bank and of Central Cleaning Plant, which merely required attendance of board meetings (R. 61). He acquired a 25 per cent interest in Central in the 1930's and still held it at the time of trial.

Petitioner took part in the management of a garage in which his brother and he were partners, and loaned money to the enterprise. Subsequent to the year in question he became 99 per cent stockholder in the Oliver Gear Works of which he was president and manager. He left part of his salary on deposit with

them and received interest thereon. He also owns and manages a business building in Buffalo. All of these enterprises were in addition to petitioner's activities with Llenroc.

Petitioner investigated numerous other businesses in which he decided not to obtain an interest.

Petitioner was in the business of giving financial aid and personal services to business ventures and, therefore, the $38,220 represented a bad debt which arose from a business regularly engaged in by petitioner which became worthless in 1945" (R. 61, 62).

As has been pointed out above, there was no disagreement in the Tax Court on the findings of specific facts but merely as to the ultimate finding or conclusion drawn therefrom.

These findings were supported by copious legal and competent evidence. The taxpayer was an investor in and engaged in a managing capacity in at least eight different business enterprises, mostly of a corporate character. He loaned money to at least six of these ventures. He investigated numerous other business ventures with the idea in mind of becoming interested in them financially and acting in a managerial capacity. All these activities covered a period of many years. The conclusion of fact arrived at by the Tax Court is supported not only by the specific findings but by the entire evidence presented to that Court (R. 7, 8, 13, 14, 15, 22-28, 30-36, 42-46).

Reasons for the Allowance of the Writ.

1. In its reversal of a decision of the Tax Court on a question of ultimate fact based on specific findings and not clearly erroneous, as to what constitutes "trade or business" within the meaning of Section 23 (k) of the Internal

Revenue Code, the Court of Appeals for the Second Circuit acted contrary to and in conflict with applicable decisions of this Court.

Whether or not the bad debt of $38,220.00 deducted by the petitioner was one "the worthlessness of which" was incurred in his "trade or business" was a question of fact. *Higgins v. Commissioner*, 312 U. S. 212, 217.

On this subject Treasury Regulations 111, Sec. 29.23 (k) —6, states:

> "The question whether a debt is one the loss from the worthlessness of which is incurred in the taxpayer's trade or business is a question of fact in each particular case."

Insofar as here applicable Rule 52 of the Rules of Civil Procedure for District Courts, provides:

> "Findings by the Court.-(a). Effect. In all actions tried upon the facts without a jury or with an advisory jury, the Court shall find the facts separately and state separately its conclusions of law thereon, and direct the entry of the appropriate judgment; * * *. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of witnesses."

This Court has expressed itself clearly as to the meaning of the words "clearly erroneous" and as to when findings of fact may be set aside. In *United States v. Yellow Cab Co.*, 338 U. S. 338, 341, 342, the Court said:

> "It ought to be unnecessary to say that Rule 52 applies to appeals by the Government, as well as to those by other litigants. There is no exception which permits it even in an anti-trust case, to come to this court for what virtually amounts to a trial *de novo* on the record of such findings as intent, motive and design. While, of course, it would be our duty to correct clear error, even in findings of fact, the govern-

ment has failed to establish any greater grievance here than it might have in any other case where the evidence would support a conclusion either way, but where the trial court has decided it to weigh more heavily for the defendants. Such a choice between two permissible views of the weight of evidence is not 'clearly erroneous'."

In *United States v. United States Gypsum Company,* 333 U. S. 364, at 395 the Court held that findings of fact are not clearly erroneous unless "* * * the reviewing Court on the entire evidence is left with the definite and firm conviction that a mistake has been committed."

In *Boehm v. Commissioner of Internal Revenue,* 326 U. S. 287; 90 L. Ed. 78, at page 293 of the Official Report, the Court said:

> "But the question whether particular corporate stock did or did not become worthless during a given taxable year is purely a question of fact to be determined in the first instance by the Tax Court, the basic fact-finding and inference-making body. The circumstances that the facts in a particular case may be stipulated or undisputed does not make this issue any less factual in nature. The Tax Court is entitled to draw whatever inferences and conclusions it deems reasonable from such facts and an Appellate Court is limited under familiar doctrines to a consideration of whether the decision of the Tax Court is 'in accordance with law' * * * If it is in accordance with law it is immaterial that different inferences and conclusions might fairly be drawn from the undisputed facts. *Commissioner of Internal Revenue against Scottish American Investment Company,* 323 U. S. 119, 89 L. Ed. 113."

Continuing at page 294 the Court said:

> "We are unable to say that the Tax Court's inferences and conclusions on this factual matter are so unreasonable from an evidentiary standpoint as to require a reversal of its judgment."

It is true that the Boehm case was decided prior to the amendment of Sec. 1141, Title 26 U. S. C. making decisions of the Tax Court appealable to the Circuit Court of Appeals, in the same manner and to the same extent as decisions of the District Courts in Civil actions without a jury, and allowing review by the Supreme Court of the judgment of the Court of Appeals upon certiorari. Be this as it may, the reasoning applied in the Boehm case is still sound, and it is submitted that under the present state of the law inferences and conclusions of a reasonable character drawn by the Tax Court from facts found by it should not be set aside.

In the *United States v. National Association of Real Estate Boards,* 339 U. S. 485, 94 L. Ed. 1007, the trial Court found that two of the appellees did not conspire with the Washington Board to fix and prescribe the rates of commission to be charged by members of that Board. No more particularized findings were made. After quoting Rule 52 of the Federal Rules of Procedure, this Court said at page 495:

> "It is not enough that we might give the facts another construction, resolve the ambiguities differently, and find a more sinister cast to the actions which the District Court apparently deemed innocent. * * * We are not given those choices because our mandate is not to set aside findings of fact 'unless clearly erroneous'."

Notwithstanding the amendment of the statute as mentioned above, since the decision in *Dobson v. Commissioner of Internal Revenue,* 320 U. S. 489, 88 L. Ed. 248 much of what was said in that decision is still sound. A number of the principles there enunciated were unaffected by the amendment of the statute. Weight should still be attached to decisions of the Tax Court on legal questions involving taxes, because of that Court's peculiar competence, and findings in no event should be lightly set aside.

The Court of Appeals termed the finding of the Tax Court in this case to the effect that the Petitioner's bad debt loss was incurred in his trade or business an "ultimate finding", and called this "an issue of law".

This creates another one of those confusing situations which we frequently find in this type of case. Whether the term "ultimate finding" is the proper term to be used in connection with the determination that the petitioner sustained a bad debt loss the worthlessness of which was incurred in his trade or business, or not, does not change the situation in any respect. There was no issue of law whatsoever involved in this determination. As is pointed out above, whether or not a loss is incurred in a taxpayer's trade or business is always a question of fact. The Court of Appeals for the Second Circuit in *City Bank Farmers Trust Co. v. Commissioner of Internal Revenue,* 112 F 2d. 457, at page 459 stated:

> "Whether the activities of a taxpayer are sufficient to place him in the category of one engaged in carrying on a business is largely a matter of degree."

The finding of the Tax Court which has been termed an "ultimate finding" by the Court of Appeals was merely a conclusion of fact based upon the findings of primary facts.

John Kelly Co. against Commissioner of Internal Revenue, 326 U. S. 521, 528, 90 L. Ed. 278, presented a situation very similar to ours. At page 528 of the Official Report this Court said:

> "* * * in the present cases it might be said to be a question of law as to whether the primary facts adduced made the payments under consideration dividends or interest. But we think such conclusion gives inadequate weight to the purpose of the Tax Court."

Continuing at page 530 this Court said:

> "These cases now under consideration deal with well understood words used in the Tax Statutes—'interest' and 'dividends'. They need no further definition * * *. The Tax Court is fitted to decide whether the annual payments under these corporate obligations are to be classified as interest or dividends. The Tax Court decisions merely declare that the undisputed facts do or do not bring the payments under the definition of interest or dividends."

The same reasoning applies strongly to our case. No definition of the term "trade or business" has ever been put either in the statute or in the Regulations.

We submit that the decision of the Court of Appeals for the Second Circuit reversing the Tax Court's finding of a conclusion of fact based upon specific findings is clearly in conflict with the above applicable decisions of this Court.

2. The decision of the Court of Appeals for the Second Circuit that as a matter of law the varied and extensive engagement in the management of, investment in, and loaning of money to corporate and non-corporate business enterprises, no matter how numerous, by an individual taxpayer over a long period of years, is not a trade or business, should be reviewed by this Court because:

(a) The decision is in conflict with the decisions of Courts of Appeals for other Circuits.

While we do not recede from our position taken above that the question as to whether or not petitioner sustained a loss from a bad debt, the worthlessness of which was incurred in his trade or business was strictly one of fact, and that the conclusion of the Tax Court based on its specific findings was a finding of fact which should not be disturbed on appeal, we do contend that there are decisions

rendered by the Courts of Appeals of other circuits in conflict with the decision in our case and holding that as a matter of law activities similar to those carried on by the petitioner constitute "trade or business" within the meaning of Section 23 (k) of the Internal Revenue Code.

In the recent case of *Commissioner of Internal Revenue v. Estate of Stogdell Stokes, et al.* 200 F. 2d. 637, 3rd Cir. (decided January 7, 1953), the question was as to whether the taxpayer was entitled to a business bad debt deduction pursuant to Section 23 (k) (1) of the Internal Revenue Code. At page 638, the Court said:

> "In the case before us the Tax Court found the decedent was engaged individually in the business of exploiting patents, either by organizing, financing, and actively participating in the management of companies organized to acquire or operate under them, or by transferring such patent rights to existing companies in which he was a stockholder and active in the management thereof".

The Commissioner urged that these activities did not amount to a "trade or business" within the meaning of Section 23 (k) (1) and (4).

Continuing at page 638, the Court said:

> "It is true that the activities of an individual in investing and reinvesting his assets in corporate securities do not constitute a trade or business within the meaning of the Internal Revenue Code. *Higgins v. Commissioner* 1941, 312 U. S. 212 * * *, *White's Will v. Commissioner of Internal Revenue*, 3 Cir. 1940, 119 F. 2d 619 * * *. It is likewise true that activities of an individual as a stockholder, director or officer of a corporation in conducting the business of the corporation do not amount to the carrying on of a personal trade or business by the taxpayer within the meaning of the Code. *Dalton v. Bowers*, 1932, 287 U. S. 404 * * *. *Burnet v. Clark*, 1932, 287 U. S. 410 * * *. An individual taxpayer ordinarily may not thus pierce the corporate veil for his own benefit, taxwise.

> In the present case, however the decedent was engaged in much more than merely investing his assets or merely managing corporations, in which he was interested. He was, as the Tax Court found 'engaged individually in the business of exploiting patents'. It is true that he exploited his patents through corporations in which he was active. But the evidence established that his activities in locating, developing and exploiting patents involved much more than the mere investment of funds in and management of corporations. It was quite clearly a personal activity in which a major portion of decedent's lifetime, thought and energy was enlisted and in which he engaged continuously and regularly throughout his business career."

In Maloney v. Spencer (C. C. A. 9th Cir.) 172 F. 2d. 638, the taxpayer organized three corporations. He owned the entire stock of each, aside from the directors' qualifying shares. The corporations were formed to carry on three fruit, berry, and vegetable packing, canning and dehydrating operations which had previously been carried on by the taxpayer as an individual.

Prior to incorporation he acquired and improved one plant. He also leased part of a second plant, bought land adjoining the same and erected buildings equipped for canning thereon. In the year of incorporation he purchased a dehydrating plant.

He leased one of these three plants to each of the three corporations and in the leases agreed that he would provide his tenant with adequate financing.

Taxpayer paid for his stock in two of the corporations by turning over to them contracts which he had with suppliers of vegetables and fruits. These two corporations thus started with an established business, but without cash.

Due to war conditions, the corporations had difficulty in obtaining credit and the taxpayer gave his joint notes

for several hundred thousand dollars to obtain financing for them. He treated the payments of these obligations as loans to the corporations on his books, and on the corporate books.

As landlord, he improved the three rented plants to the extent of $100,000.00. He spent a third of his time in performing his activities as landlord, in discharging the financial obligations of his leases and in travel seeking war time certificates of necessity for the required building materials needed to improve the leased plants.

The remaining two-thirds of his time was spent in performing his duties as an officer of the three companies.

One of the corporations operated but one season, and a second for only two. Both failed. The taxpayer paid $95,018.48 of their debts upon his financing agreement.

In affirming the holding of the District Court that the taxpayer was entitled to a net operating loss carry-back within the meaning of Section 122 of the Internal Revenue Code, 26 U. S. C. A. 122, the Court said at page 640:

> "We think the District Court's finding that the taxpayer was engaged 'in the business of acquiring, owning, expanding, equipping and leasing food processing plants' is not 'clearly erroneous' * * *."

> "Here the taxpayers activities were 'extensive, varied, continuous and regular' as in *Daily Journal Co. v. Commissioner,* 9 Cir. 135, F 2d, 687, 688 and *Miller v. Commissioner,* 9 Cir., 102 F 2d 476. Here is the 'frequency and continuity of the transaction' resulting in a business status of *Commissioner v. Boeing,* 106 F 2d. 305, 319, certiorari denied, 308 U. S. 619 * * *. Here the taxpayer was engaged in two businesses as in *Daily Journal v. Commissioner, supra* * * * and *Harvey v. Commissioner,* 9 Cir., 171 F 2d 952. Like the instant case are *Fackler v. Commissioner,* 6 Cir., 133 F 2d 509; *Kales v. Commissioner,* 6 Cir., 101 F 2d 35 * * *; *Foss v. Commissioner,* 1 Cir., 75 F 2d 326."

"Here is the 'regularity' as distinguished from the 'isolated or occasional transaction' of *Burnet v. Clark*, 287 U. S. 410 * * * and *Dalton v. Bowers*, 287 U. S. 404 * * *. Also is the multiplicity of transactions required by the several leases creating a business obligation to the corporations as distinguished from the 'single transaction' occurring in the 'lifetime' of the taxpayer, 'but once' of *Deputy v. Dupont*, 308 U. S. 488 * * *."

In *Washburn v. Commissioner of Internal Revenue*, 51 F. 2d, 929, decided by the Court of Appeals for the 8th Circuit, the petitioner, a lawyer, retired from the practice of law to give his entire time to the management of various corporate enterprises in which he was heavily interested. The salaries received by him from these enterprises were payments intended only to reimburse him for actual expenses in connection with the services rendered by him. He received some bonuses in appreciation of his services but there was no legal obligation to pay him either salary or bonuses. Among other things, in 1913, he organized a railroad 14 miles long to open up timber lands belonging to one of the companies. He was its principal stockholder and managed its affairs. He advanced money to it and received stock in return. He sold this stock in 1922 sustaining a loss of about $112,000.00. The question involved was as to whether the stock loss resulted from the operation of any trade or business regularly carried on by the taxpayer. It was held that it did.

In *Hughes against Commissioner of Internal Revenue*, 38 F. 2d 755, the Circuit Court of Appeals for the 10th Circuit held that where one-fifth of the taxpayer's time was devoted to looking after his investments, that he was engaged in the investment banking business.

In *Miller v. Commissioner of Internal Revenue*, 102 F. 2d 476, 479, 9th Cir. the Court said:

"The courts have held that where a man takes an active part in the management of an enterprise in which he has investments his activities amount to the carrying on of a trade or business, but they have drawn the line between such cases, and those where the activities of the party are merely looking after investments and doing only what is necessary from an investment point of view. *Bedell v. Commissioner,* 2 Cir., 1929 30 F. 2d 622 * * *.

Other cases have recognized that though the taxpayer takes no part in the enterprises as to which he is an investor, he may nonetheless be considered to be carrying on a business if the transactions concerning his investments are substantial and frequent as distinguished from occasional or isolated."

In *Foss against Commissioner of Internal Revenue,* 75 F. 2d 326, which was decided by the Court of Appeals for the 1st Circuit, the question was as to whether the taxpayer was entitled to a deduction for the expenses of defending a successful suit brought against him and others by minority stockholders of a corporation claiming waste, violation of the Sherman Act and other illegal acts. This deduction was granted under Section 214 (a) of the Revenue Act of 1918, which stated:

"That in computing net income there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."

Foss was a man of many interests. He was president of a manufacturing company, a water company, a real estate company and was director of many other companies, including banks, railroads, and a stockyard. From 1911 to 1913 he was Governor of Massachusetts. He devoted his time to looking after his investments and to the operation of the various corporations of which he was an officer and director. In holding that he was entitled to the deduction, at page 327 the Court said:

> "A person of property who devotes his time to the active management of it and also to active participation in the management of the companies in which his property is invested, and who maintains an office for that purpose where he spends a substantial part of his time, is carrying on business within the meaning of the statute."

Continuing at page 328, the Court said:

> "The line comes between those who take the position of passive investors, doing only what is necessary from an investment point of view, and those who associate themselves actively in the enterprises in which they are financially interested, and devote a substantial part of their time to that work as a matter of business."

In *Kales v. Commissioner,* 101 F. 2d 35, the Circuit Court of Appeals for the 6th Cir., held that the term "business" meant the same thing under section 23 (a) of the Internal Revenue Code as it did in the statute before the Court in the *Foss* case, *supra.* The Court held that the broad and comprehensive rule laid down by this Court in *Flint v. Stone Tracy Co.,* 220 U. S. 107, applied in all its force, and at page 171 said:

> "It has long been a recognized rule of statutory construction that the re-enactment of a statute by Congress in identical terms and failure to amend it in the face of consistent judicial and administrative construction is persuasive of a legislative recognition and approval of the statute as thus construed. *Brewster v. Gage,* 280 U. S. 327 * * *; *Helvering v. Bliss,* 293 U. S. 144, 151, * * *. A long line of Treasury decisions were promulgated before the passage of the 1928 Act defining 'business' with substantially the breadth given to it in *Flint v. Stone Tracy Co., supra,* yet section 23 of that act re-enacted similar provisions of section 214 of the Acts of 1918, 1921, 1924 and 1926. 40 Stat. 1066, 42 Stat. 239, 43 Stat. 269, 44 Stat. 26."

It thus appears that when Congress amended Section 23 (k) of the Internal Revenue Code in 1942, it intended

no different meaning for the words "trade or business" than the meaning which had been attached to them by the courts and by the Treasury Department over a long period of years. Had it intended any other meaning it would have said so.

It is extremely difficult to reconcile the decision of the Court of Appeals for the Second Circuit in our case with its decision rendered on February 5th, 1953 in *Gilford v. Commissioner of Internal Revenue,* 201 F. 2d 735 where the Court held a part owner of an apartment block who took no active part in the management, but employed a manager had sustained a business loss rather than a capital loss when the premises were sold in 1944, sixteen years after the acquisition of her first interest in the same. Citing *Fackler v. Commissioner of Internal Revenue,* 133 F. 2d 509, decided by the Court of Appeals for the 6th Circuit and *Pinchot against Commissioner of Internal Revenue,* 113 F. 2d 718, (C. C. A. 2nd Cir.), the Court said at page 736:

> "During all the time from 1928 to 1944 it is to be taken for granted that the purpose while she held her interest was to get what income she could from rentals. That required not only the maintenance of the eight buildings in rental condition but also the supplying of such services for the tenants as were needed to rent them to good advantage. Such necessarily, regular and continuous activity falls within the concept of trade or business as that phrase is used in the relevant statute."

(b) The Court of Appeals for the Second Circuit decided a Federal question in a way in conflict with the applicable decisions of this Court.

The Circuit Court completely discarded the definition of business laid down by this Court in *Flint v. Stone Tracy Co., supra,* and misapplied and misinterpreted the hold-

ings of this Court in *Higgins against Commissioner of Internal Revenue,* 312 U. S. 212, *Burnet v. Clark,* 287 U. S. 410, and *Dalton against Bowers,* 287 U. S. 404. As we have pointed out above when Congress amended Section 23 (k) of the Internal Revenue Code in 1942, it used the words "trade or business" with the same meaning that they had been found to have by the Courts and by the Treasury Department, previous to the amendment of the statute. In *Cluett v. Commissioner of Internal Revenue,* 8 T. C. 1178, after pointing out that before the amendment of the law complete deduction of any bad debt loss was allowable, the Tax Court said at page 1179:

> "The legislative history of section 23 (k) (4) indicates that its principal purpose was to place a limitation upon losses from bad debts, such as loans to relatives or friends which had *no connection* with the business of the lender. Section 23 (k) (1) allows a deduction for debts which become worthless during the taxable year but does not apply in the case of an individual to a non-business debt as defined in paragraph 4 of subsection (k)." (Italics ours.)

That this was the intention of Congress is to be found by a reference to the Cumulative Bulletin, 1942-2, 372, 408, 409 where the following statement appears:

> "The present law gives the same treatment to bad debts incurred in non-business transactions as it allows to business bad debts. (An example of a non-business bad debt would be an unrepaid loan to a friend or relative while business bad debts arise in the course of the taxpayer's trade or business. This liberal allowance for non-business bad debts has suffered considerable abuse through taxpayers making loans which they do not expect to be repaid. This practice is particularly prevalent in the case of loans to persons with respect to whom the taxpayer is not entitled to a credit for dependents.) The situation has created serious administrative difficulties because of the requirement of proof.

> The bill treats the loss from non-business bad debts as a short term capital loss."
> (Italicize that part in parentheses.)

It would appear from the foregoing that the decision of the Court of Appeals was in conflict with *Flint v. Stone Tracy, supra.*

In the *Higgins* case, *supra,* the question was as to whether or not the taxpayer was entitled to deduct office rent, salaries, and other expenses incurred in connection with the handling of his own personal investments, pursuant to provisions of Section 23 (a) of the Internal Revenue Code.

Petitioner did not participate either directly or indirectly in the management of the corporations in which he held stocks and bonds. He merely kept records and collected interest and dividends from his securities. The Court held that this type of activity did not constitute engaging in "trade or business." In applying the decision in the *Higgins* case, *supra* to our case, the Court of Appeals clearly misapplied the decision of this Court.

Neither *Burnet against Clark,* 287 U. S. 410, nor *Dalton against Bowers,* 287 U. S. 404 is a case like ours although it would appear that the Circuit Court (R. 83, 84) regarded the decision in the *Clark* case as controlling. In the *Clark* case, an examination of the decision will disclose that the question involved was as to whether or not Clark was entitled to a net loss carry-over resulting from the operation of any "trade or business *regularly* carried on." (Italics ours.) The losses which Clark sought to deduct were occasioned through the sale of the corporation's stock and his endorsement of some of the corporation's notes. This Court held that he was neither regularly carrying on the business of endorsing notes for profit nor an investment business, and that his endorsements were occasional isolated transactions.

Dalton against Bowers, 287 U. S. 404, was a case where the statute involved was also one involving a net loss "attributable to the operation of a trade or business regularly carried on by the taxpayer." He was the sole stockholder, a director and president and treasurer of a corporation. The corporation became insolvent and he attempted to deduct his stock loss as one resulting from "a trade or business regularly carried on" by him. The Court held that the loss was an investment loss, which did not occur in the operation of such a trade or business.

It must be seen that the Court of Appeals misinterpreted and misapplied both of the last two mentioned decisions of this Court. In both cases the statute involved required that the loss result from a "*trade or business regularly carried on.*" Section 23 (k) merely requires that the bad debt be one "the worthlessness of which is incurred in the taxpayer's trade or business."

(c) The decision is inconsistent with numerous decisions of the Tax Court and is contrary to the rules applicable throughout the country.

The issue before the court in this case has been passed upon in numerous well reasoned decisions by the Tax Court. The recent cases of Vincent G. Campbell v. Commissioner of Internal Revenue, 11 TC 510; Henry E. Sage v. Commissioner of Internal Revenue, 15 TC 299; Fisher Brown v. Commissioner of Internal Revenue 9 TCM 1054 and Cluett v. Commissioner of Internal Revenue, 8 TC 1178 are not distinguishable from our case. In each the activities of the taxpayer were of an extensive nature; in each he did not adopt the role of a passive investor, but actively participated in the management of the enterprises; and in each he made loans and not mere contributions to

capital. It is significant that the government acquiesed in both the Henry E. Sage and Fisher Brown cases.

The attitude of the Tax Court on this precise question is well indicated by the opinion in this case, which was joined in by ten members of the court.

(d) The decision decided an important question of Federal Law which has not been, but should be, settled by this court. As has been seen from the decisions, both of the Courts of Appeals of the various circuits mentioned above, and of the Tax Court, there has evolved a fairly definite rule that activities, similar to those of the petitioner in this case, constitute "trade or business" within the meaning of Section 23 (k) of the Internal Revenue Code. However, this question has never been passed upon by this Court and it puts millions of taxpayers all over the United States in a quandary as well as placing the citizens within the jurisdiction of the Court of Appeals for the 2nd Circuit, at a peculiar disadvantage. It places honest taxpayers like the petitioner in an uncertain position, and subjects them to the whim and caprice of the Commissioner of Internal Revenue. It makes it possible for him to apply one rule when it is favorable to the government, and another rule when the first rule is not favorable to the government.

Taxpayers like the petitioner may find themselves in the same position in which he finds himself. It may be necessary for them to incur heavy expense to test out in court the question as to whether they are entitled to a business bad debt deduction. If the amount of the tax imposed is so great that they cannot conveniently pay it, they may be further penalized by the adding of interest at the rate of 6% per annum from the time when the tax was due to the time when it is paid.

It is submitted, therefore, that this question is a most important one of broad general interest to every taxpayer in the United States, and that it should be decided once and for all by this Court.

CONCLUSION.

For the reasons stated, this petition for a writ of certiorari should be granted.

May 26, 1953.

Respectfully submitted,

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APPENDIX.

STATUTES, RULES AND REGULATIONS INVOLVED.

Title 28 U. S. C. Sect. 1254 (1.)

Courts of appeals—Certiorari—Appeal—Certified questions.—Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

1. By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;

Internal Revenue Code, Sect. 1141 (Tit. 26 U. S. C., Sect. 1141).

Courts of review.—(a) Jurisdiction.—The Courts of appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 1254 of title 28 of the United States Code.

Rule 52 (a) Rules of Civil Procedure for District Courts:

> "Findings by the Court.—(a). Effect. In all actions tried upon the facts without a jury or with an advisory jury, the Court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; * * * Findings of fact shall not be set aside unless clearly erroneous, and due regards shall be given to the opportunity of the trial court to judge of the credibility of witnesses. * * *".

Internal Revenue Code, Sec. 23, (Tit. 26 U. S. C. Sect. 23)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(k) [as amended by Sec. 124 (a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Bad Debts.*—

(1) *General Rule.*—Debts which become worthless within the taxable year; * * *. * * * This paragraph shall not apply in the case of a taxpayer, other than a corporation, with respect to a non-business debt, as defined in paragraph (4) of this subsection. * * *

* * *

(4) *Non-Business Debts.*—In the case of a taxpayer, other than a corporation, if a non-business debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months. The term "non-business debt" means a debt other than a debt evidenced by a security as defined in paragraph (3) and other than a debt the loss from the worthlessness of which is incurred in the tax payer's trade or business.

(26 U.S.C. 1946 ed., Sec. 23.)

* * *

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.23(k)-6 [as amended by T.D. 5458, 1945 Cum. Bull. 45]. *Non-Business Bad Debts.*—In the case of a taxpayer, other than a corporation, if a non-business bad debt becomes entirely worthless within a taxable

year beginning after December 31, 1942, the loss resulting therefrom shall be treated as a loss from the sale or exchange of a capital asset held for not more than six months. Such a loss is subject to the limitations provided in section 117 with respect to gains and losses from the sale and exchange of capital assets. A loss with respect to such a debt will be treated as sustained only if and when the debt has become totally worthless, and no deduction shall be allowed for a non-business debt which is recoverable in part during the taxable year. Nor are the provisions of this subdivision applicable in the case of a loss resulting from a security as defined in section 23(k)(3). A non-business debt is a debt, other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business and other than a debt evidenced by a security as that term is defined in section 23(k) (3). The question whether a debt is one the loss from the worthlessness of which is incurred in the taxpayer's trade or business is a question of fact in each particular case. The determination of this question is substantially the same as that which is made for the purpose of ascertaining whether a loss from the type of transaction covered by section 23(e) is "incurred in trade or business" under paragraph (1) of that section.

The character of the debt for this purpose is not controlled by the circumstances attending its creation or its subsequent acquisition by the taxpayer or by the use to which the borrowed funds are put by the recipient, but is to be determined rather by the relation which the loss resulting from the debt's becoming worthless bears to the trade or business of the taxpayer. If that relation is a proximate one in the con-

duct of the trade or business in which the taxpayer is engaged at the time the debt becomes worthless, the debt is not a non-business debt for the purposes of this section.

To illustrate: A, an individual engaged in the grocery business and who makes his income tax returns on the calendar year basis, extends credit on an open account to B in 1941.

(1) In 1942 A sells the business but retains the claim against B. The claim becomes worthless in A's hands in 1943. A's loss is controlled by the non-business debt provisions. While the original consideration was advanced by A in his trade or business, the loss was not sustained as a proximate incident to the conduct of any trade or business in which he was engaged at the time the claim was worthless.

(2) In 1942 A sells the business to C but sells the claim against B to the taxpayer, D. The claim becomes worthless in D's hands in 1943, at a time when D is not engaged in a trade or business incident to the conduct of which a loss from the worthlessness of such a claim would be a proximate result. D's loss is controlled by the non-business debt provisions, even though the original consideration was advanced by A in his trade or business.

(3) In 1942 A dies, leaving the business, including the accounts receivable, to his son, C, the taxpayer. The claim against B becomes worthless in C's hands. C's loss is not controlled by the non-business debt provisions. While C did not advance any consideration for the claim or acquire it in carrying on his trade or business, the loss was sustained as a proximate incident to the conduct of the trade or business in which he was engaged at the time the debt became worthless.

(4) In 1942 A dies, leaving the business to his son, C, but the claim against B to his son, D, the taxpayer. The Claim against B becomes worthless in D's hands in 1943, at a time when D is not engaged in a trade or business incident to the conduct of which a loss from the worthlessness of such a claim would be a proximate result. D's loss is controlled by the non-business debt provisions, even though the original consideration was advanced by A in his trade or business.

(5) In 1942 A dies and while his executor, C, is carrying on the business, the claim against B becomes worthless. The loss sustained by A's estate is not controlled by the non-business debt provisions. While C did not advance any consideration for the claim on behalf of the estate or acquire it in carrying on a trade or business in which the estate was engaged, the loss was sustained as a proximate incident to the conduct of the trade or business in which the estate was engaged at the time the debt became worthless.

(6) In 1942, A, in liquidating the business, attempts to collect B's claim but finds that it has become worthless. A's loss is not controlled by the non-business debt provisions, since a loss incurred in liquidating a trade or business is a proximate incident to the conduct thereof.

* * *